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British Embassy
Washington

24 February 1997

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The Office of the Secretary
Federal Communications Commission
Room 222, 1919 M Street NW
Washington DC

Dear Mr Secretary,

**THE MERGER OF MCI COMMUNICATIONS CORPORATION AND BRITISH TELECOMMUNICATIONS PLC (DOCKET GN 96-245)**

I attach an original and nine copies of the United Kingdom Government's replies to comments filed in this matter.

Yours faithfully

Pat Phillips

Pat Phillips
First Secretary, Agriculture and Trade Policy

cc: International Transcriptions Services
2100 M Street NW, Suite 140

No. of Copies rec'd 0 18

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(by fax)

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Date 24 February 1997

Dear Pat,

**UK COMMENTS ON RESPONDENTS' COMMENTS TO THE FCC ON THE MERGER OF BT AND MCI**

I attach the UK's response comments to the FCC on BT/MCI. These are the agreed joint comments of DTI and OFTEL. Could I ask you please to forward these to the FCC in the time-honoured fashion?

Many thanks.

Yours,

Neil.

**NEIL FEINSON**
COMMUNICATIONS AND INFORMATION INDUSTRIES DIRECTORATE 2

# UK Government Comments on Respondents' Comments to the FCC on the Merger of MCI Communications Corporation and British Telecommunications plc (Docket 96-245)

**LONDON 24 February 1997**

## INTRODUCTION

1. The UK Government has read with interest the comments put forward to the FCC on the BT/MCI merger. This document expresses no opinion as to how the relevant UK, EU or US authorities should treat the merger but seeks to correct misunderstandings and inaccuracies in some of the respondents' comments to the FCC and is intended to allow the FCC to proceed with a clear understanding of the UK regulatory regime. Description of UK regulatory policies developed to meet the particular requirements of the UK market should not be interpreted as policy recommendations for other countries where the market reality may dictate a different approach.

2. Rather than commenting on each respondent's comments individually, comments have been made thematically, picking up particular respondents' comments where appropriate. The areas we propose to comment on are:

- dialling parity and aspects of equal access
- line-side unbundling
- non-geographic number portability
- interconnection charges
- access to international facilities
- proportionate return, parallel accounting and self-correspondence

3. The UK has a balanced regulatory regime which aims to encourage competition at all levels of the market - infrastructure-based operators in all areas of the network including the local loop, resellers and service providers. OFTEL shares the FCC's goal of delivering maximum consumer choice and benefit, but the regulatory tools it uses to achieve this vary slightly to reflect the different market structures in the UK and US.

4. These comments reflect a fundamental misunderstanding of the UK regulatory regime and the means by which it delivers competition particularly in respect of the absence of an obligation on BT to offer full dialling parity for access to other operators' services.

5. Equal access has played an important role in the US in bringing the benefits of competition to the long distance and international markets following divestiture, given the continuing local monopolies. In the UK, on the other hand, BT was

privatised as a vertically integrated operator, and the UK government has since pursued a balanced approach fostering both infrastructure-based and service-based competition. This policy is now bearing fruit in the local access market with over a third of the population having the choice of taking telephony from a cable TV operator, rising to 70% by the end of the century. BT is losing 50,000 customers a month to cable and ithas already lost 10% of its share of exchange lines. Further choice is in the pipeline with the growth of fixed radio access operators such as Ionica. These operators will over the next three years or so rollout their networks to cover the majority of the country and so offer a third choice of local access operator. Many business customers will have even wider choice, particularly in urban areas.

6. This is not to say that consumers must wait until competing local infrastructure has been built to benefit from service competition. Long-distance and international facilities operators and international resellers (many of which are US companies) which rely on existing local loop infrastructure to reach their customers have access to all of BT's customers on the same cost-based interconnection terms as BT's own network business itself does (under Condition 13 of BT's licence). BT is required, effectively to resell its local services. These indirect access operators and resellers have been able to enter the market quickly, choosing the level of initial investment they wish to make and are reachable by the consumer by means of a short-code prefix.

7. The UK has demonstrated that the local loop is not a natural monopoly and does not necessarily need to be ring-fenced from competitive long distance and international markets. At the same time indirect access has brought early competitive benefits in long-distance and international services to consumers and allowed those operators to make a speedy entry to the market on the same terms as BT's own network business. There is, however, a tension between indirect access and encouraging competition in the local loop. The considerable investments of the new local access operators have been made against the background of a stable UK regulatory regime and the UK will not make sudden changes to the regime unless it can be demonstrated that it will benefit the economy as a whole. Equal access is not necessarily a helpful regulatory intervention in vertically integrated competitive markets such as the UK and OFTEL's 1994 cost-benefit analysis of a possible extension of "easy access" to equal access showed clearly that this was not the case of the UK. Where competition is possible, equal access may represent an unnecessary and unwelcome prolongation of detailed regulation when market forces

are available to safegurad consumer interests.

8. Where there is currently no competition between alternative networks in the access market then lineside unbundling may indeed be a good device for getting operators into the market at an early stage. Such competition might subsequently develop into network-based competition in the access network.

9. However, where competition based on alternative infrastructures is already emerging, it is more important to maintain a stable environment against which competitors can invest and develop their businesses. To introduce line-side unbundling would risk undermining that investment and slow the development of alternative networks. This is important because without competition in the access network, it is unlikely that intrusive price regulation can ever be eliminated from the market.

10. Many respondents raised concerns based on BT's ahre of the access market in the UK, without apparently understanding the key role of the UK's interconnection regime. Condition 13 of BT's licence requires it not only to supply interconnection services at cost-based rates, but also in a non-discriminatory fashion such that other operators must be charged the same rates by BT's network business (and enjoy the same quality of service) as BT's retail business. BT is also obliged to resell its local loop service to competitors without an access network at cost to allow them "indirect access" to their customer base. In terms of originating traffic this means for example that US operators have direct access to BT's customer base while charges for delivery of traffic are guaranteed at non-discriminatory cost-based rates.

11. Respondents also raised concerns on access to international capacity for BT's competitors. Access to undersea cables is controlled by the consortia which own these cables, and neither BT nor MCI, nor both together, can on their own change the policy of a consortium. There is indeed problem about access to these cables, but it is not one addressable in the circumstances of this merger. Access to cable landing is treated as a form of interconnection in the UK and is subject to the safeguards outlined earlier, whilethe backhaul market in the UK is moving rapidly to competition BT of course must offer backhaul and its crrent prices are lower than its tariff for inland private circuits. There is a large number of potential providers of alternative backhaul services and OFTEL's discussions with them suggest that alternative backhaul is planned to be available at almost all cable stations. Of

course, any US operator which is one of the 20 UK international facilities licensees, has the option of providing backhaul for themselves

## I. DIALLING PARITY AND ASPECTS OF EQUAL ACCESS

### Introduction

12. It is important to define certain terms which are sometimes used in different ways in the UK, US and EU. For the avoidance of doubt, in this response, the terms "indirect access" and "equal access" have the following meanings:

*Indirect access:* Generic term for the system where the customer of one local access network (in practice BT) chooses, on a call-by-call basis, to route his long-distance or international traffic via the network of another operator to which he is not directly connected but from whom he has agreed to take service. The indirect access system in place in the UK is commonly known as *easy access*: long-distance or international traffic is routed via another network by adding, or having equipment insert automatically, a short-code prefix to the normal telephone number.

*Equal access:* An extension of indirect access whereby the customer elects, for a given period, which network should carry his long-distance and international traffic ("pre-selection") or there is parity in the number of digits to be dialled regardless of which long-distance or international operator is to carry the call ("dialling parity").

13. Several operators commented that the UK telecoms market is not sufficiently open due to the lack of dialling parity. These operators suggested that FCC clearance of the merger should be conditional upon implementation of dialling parity in the UK.

14. The UK has a regulatory regime which is balanced so as to support an open telecoms market in the UK. Competition is encouraged at every level of the market: infrastructure-based operators, resellers and independent service providers at the local national and international levels. The goal of the UK is the same as that of the US: full and fair competition at every level of the market delivering enduring benefits to all consumers. The regulatory tools for achieving this goal vary slightly because of the different market structures in the UK and the US.

15. At the time of divestiture in the US, the telecoms market was split between local and long-distance. Competition was encouraged in the long-distance market

but the local access operators enjoyed monopolies. Equal access brought the benefits of competition (increased choice and reduced prices) to customers. However, a side-effect of this was that local access operators became entrenched as local monopolies and relied heavily on income from access charges for their financial success. In the UK, on the other hand, BT was privatised as a vertically integrated operator and competition was encouraged at every level of the market. UK policy has had to strike a balance between the interests of local operators, resellers and independent service providers.

16. Set out below is an overview of the development of competition in various market segments. The UK's indirect access policy represents a balance between encouraging network competition and encouraging competition in services. The UK believes that promotion of competition at all levels in the supply chain of telecoms services will ultimately give the customer the best deal in the circumstances of the UK market. It will make continued detailed regulation of major parts of the UK telecoms industry unnecessary. Operators and service providers will then be able to plan their businesses as in a normal market, without the concern that future regulatory decisions on terms of access to networks could undermine provision of new services. In the longer term, the UK expects the telecoms industry to operate largely like other private sector industries.

**Local Access**

17. The investment in the local access market over the last five years is not yet fully reflected in the statistics of market shares. BT has lost 10% of exchange lines. However, the current statistics do not reflect the extent of competitive pressures in the market because of the time it takes new entrants to complete networks and build up a customer base. The market has already been transformed and BT's share of exchange lines is likely to fall further over the coming years. At the time the UK decided to liberalise the market beyond the initial BT/Mercury duopoly, the cable TV networks were little developed and the possibility of providing telephony over new cable TV networks, with a consequent double revenue stream, drove the installation of alternative new cable telephony networks. The cable companies are currently investing over £2 billion a year in new infrastructure. This compares with BT's investment of £2.45 billion in the financial year 1995/6. There are currently 13 Multiple Systems Operators (cable companies operating in more than one franchise area) in the UK. Their construction programme started in a major way

some three years ago. Nearly 8 million homes are now passed by cable operators, with over 2 million exchange lines installed, and plans to roll out across the country.

18. This means that, currently, over a third of the population has the choice of taking telephony services from cable companies and 70% of the UK population will have that choice by the end of the century. At the moment, average cable company penetration is about 24% (with operators running more successful marketing campaigns achieving penetration rates of over 30% in some areas). The cable operators are gaining around 50,000 residential customers per month, mainly at the expense of BT (although some of these new customers did not previously have telephones and others have been changing to cable operators at the same time as moving home). Customers in most major cities already have the choice of taking telephony services from a cable operator, for example NYNEX in Manchester; TeleWest in Edinburgh; CableTel in Glasgow, Cardiff and Belfast; Birmingham Cable (a joint venture including Comcast and TeleWest) in Birmingham; a range of operators including TeleWest and NYNEX in London.

19. Increasingly customers across the UK will have a further choice of an alternative access supplier. A number of radio fixed access operators are already offering service. Customers in Cambridge, where Ionica is based, already have a choice of three access operators. The new radio fixed access service was launched in East Anglia in May 1996 and the operator is obliged to roll out its network to cover 75% of England and Wales over the next three years. In Scotland, two other companies will be providing similar service. Other radio fixed access operators are also planning services.

20. Business customers in city centres have been an attractive market for infrastructure based operators such as MFS and COLT, often offering direct connection to their networks. The business market has also attracted a number of regional players which offer business customers direct connections to their modern fibre networks.

21. In the UK, experience demonstrates that the local access market should not be considered a natural monopoly. Both business and residential customers can have a choice of access operator. The UK has been able to stimulate competition in local infrastructure by promoting cable networks to offer both broadcast and telephony services and by promoting new technologies, such as radio fixed access. Competition in the local access market is essential, not only because it drives down

prices, but also because it increases consumer choice and stimulates local access operators and the incumbent to offer new and innovative services. Without competition in the local access market, innovation is likely to be stifled: the incumbent will be able to benefit from its market power to act as 'prime mover' by dictating the pace of change.

**Voice Resale in the UK**

22. Since the end of the duopoly regime in 1992, the UK market for voice services has been evolving rapidly with a range of new entrants competing with BT and Mercury. Generally new entrants have not chosen to build complete networks to compete in all sectors of the market. The openness of the UK regime, with interconnect services available at cost-oriented prices, has encouraged entrants to adopt a range of strategies. Some have invested heavily in access or transmission infrastructure and others have only invested in switching infrastructure, reselling transmission capacity provided by other operators.

23. Amongst the first competitors to BT and Mercury were operators offering international call services through International Simple Resale (ISR). Generally these operators only own switches. Customers access ISR operators either through indirect access, or in the case of large users close to switches, using private leased circuits. Call transmission overseas is via international private leased circuits or, to countries where this is not viable, through reselling IDD interconnect services from other operators.

24. The impact of ISR on BT's market share on the UK/US route has been dramatic. For the period Sep - Dec 1996 BT's market share (by traffic minute volumes) on UK /US routes was 49%. For the period September-December 1996 ISR operators had 35% of the outbound minutes on the UK/US route and indirect operators an 18% share of the revenues for international calls on all routes (up from a 5% share a year earlier).

25. Most of the ISR operators are UK subsidiaries of overseas operators and have targeted larger business users. They include Golden Pages, ACC, Global One, Esprit and AT&T. The biggest ISR operator is MFS/WorldCom, with 8% of the business market (by revenue) in mid-1996. Residential customers have also benefited from competition from operators using indirect access and passing the traffic on to either the larger ISR operators or to companies with an international

licence. Other operators offer ISR services accessed by 0800 two-stage indirect access or a short-code prefix.

26. Some operators that only own switches, such as ACC Long Distance and AT&T, have also been offering national calls. These operators offer service either by either using leased circuits to carry calls or by reselling wholesale interconnect services. However the impact of resellers in this market has been more limited than for international services because of the smaller margins because of cost-orientated retail prices. In UK terminology these resale operations are generally termed indirect access operators to distinguish them from the operators offering infrastructure access.

**Indirect Access in the UK**

27. Indirect access operators are able to enter the market quickly, choosing the level of initial investment they wish to make. Competition from indirect access operators for long distance and international calls is important in bringing early benefits of competition to customers. However, indirect access does create a tension between encouraging competition in the local access network and encouraging competition in the long-distance and international markets.

28. The UK indirect access system represents a balance and should help the UK to achieve its long-term goal of encouraging competition at every level of the telecoms market. The UK's objective is not to encourage either network competition or services competition, but both network competition and services competition. The balance is struck in the UK by requiring BT to resell services so that other operators can be accessed by adding a short-code prefix to the normal telephone number. (The inconvenience of entering short access codes can be minimised by programming memory phones to add the required digits and by some indirect operators offering, usually at no cost to customers, 'smart' phones which automatically add the access code where appropriate.) Where a new local access operator is found to have some 25% of its relevant market, the Director General of OFTEL will decide whether that operator should be obliged to offer the same service. Before doing so, the Director General will consider various factors, including the size of market shares of other operators in that market and the overall effect on competition in the relevant market.

## Indirect Access' Place in the UK's Regulatory Framework

29. In the UK, prices of long distance calls have fallen by around 60% in real terms since privatisation of BT in 1984 and international call prices have fallen by 40% since they were brought within the retail price controls in 1991. Competition from indirect access providers will have played a part in promoting these reductions, but only a part. Other factors will have had an important effect in driving down prices and giving customers a better deal:

- Competition from Local Access Operators;
- Price Control;
- Cost-oriented retail prices; and
- Other Measures to Promote Competition; including:
  - Geographic Averaging;
  - Cost-oriented Interconnection;
  - Number Portability; and
  - OFTEL control of numbering administration.

30. New entrants considering investing in the UK look at the regulatory regime as a whole. Indirect access arrangements will only be one element under consideration and not the most significant one in terms of their business planning. Indirect access operators considering the UK market will see good opportunities for developing their businesses: they get interconnection at cost-oriented prices and they pay no charges for use of the incumbent's access network (ie between the remote concentrator unit and the customer's premises) when interconnecting for call origination or termination. The costs of the access network are met from retail prices - through the line rentals and call charges paid by BT's retail customers, rather than through charges paid by interconnecting operators.

## Competition in Service Provision

31. Whilst the market for voice telephony is currently dominated by companies operating their own networks, the openness of the UK market has encouraged entry by a large number of other operators offering a range of services over those companies' networks. The areas where such "independent service providers" have entered this market are generally in value-added or "enhanced" services, such as internet access, electronic mail, on-line databases, "premium rate" services, voice

mail and personal numbering. In some of these areas, established network operators are now offering competing enhanced services.

32. Much of the growth in the industry is due to the expansion of these innovative services and this growth is forecast to continue with many small entrepreneurs entering the market. For example, there are currently over 200 service providers offering Internet access to up to half a million subscribers. Other computer data services, such as electronic mail and on-line databases, are also showing high rates of growth. Another new service, launched in 1993, is personal numbering, which allows users to direct incoming calls to any telephone. By the end of 1996, the six service providers offering personal numbering had around 30,000 subscribers between them. The market for some other services provided over telecoms networks is more mature, such as premium rate services, where there are about 900 service providers, generating around £250 million a year.

**The importance of regulatory stability**

33. The increase in competitive choice (and the benefits that go with it) outlined above can be attributed partly to technological advances and partly to the UK regulatory regime. It is the existence of a stable regulatory regime that has given new entrants the confidence to invest in the UK telecoms market. New entrants in the local access market, particularly cable companies, have invested in building out local infrastructure, based on business plans drawn up against the background of the current UK regulatory regime. Other deals, such as the proposed merger to create Cable & Wireless Communications, have been structured on the basis of the UK regulatory regime as it currently stands. The UK does not change its regulatory regime, risking the value of past investment and the possibility of future investment, unless analysis suggests that the change would clearly be beneficial to the economy as a whole.

**Cost Benefit Analysis in the UK**

34. In 1994, OFTEL undertook a cost benefit analysis to consider whether the current indirect access arrangements should be extended to provide for equal access. The study concluded that there were no benefits to customers from dialling parity because of extra digit dialling requirements. Incremental benefits (over current arrangements) for alternative options involving pre-selection with call-by-call override ranged from £43 million to £79 million over 10 years. These

were, however, greatly outweighed by the costs of around £160 million. The greatest costs arising from the introduction of equal access were found to be those relating to data build in switches and staff, training and organisational matters. Most of the potential benefits accruing from carrier pre-selection have already been realised in the UK under the current indirect access arrangements.

35. OFTEL concluded that there was, *"no conclusive evidence that ... equal access has benefits that exceeds its costs"*. In the light of the study's findings, the UK decided it was not appropriate to change its current arrangements.

## II. LINESIDE UNBUNDLING

36. Only three operators commented on the lack of lineside unbundling in the UK (known in the UK as "direct access to the copper loop"). Of these three operators, only one, WorldCom, currently holds a UK licence.

37. In countries where there is no competition between alternative access networks, lineside unbundling might turn out to be a good device for getting operators into the market at an early stage. It would also reduce the costs of indirect access operators because they would be able to avoid use of part of the incumbent's network between the old point of interconnect and the access line. The indirect access operator would also avoid access charges, if there are any, but would have to pay a cost-oriented charge for leasing of the access line.

38. However, in the UK, where prices are in line with costs, interconnection charges are to be based on long-run incremental costs and access charges have been abolished, the cost advantages of lineside unbundling would appear to be small. Moreover, it seems unlikely that the introduction of lineside unbundling would add anything to the promotion of local competition in the UK, whilst an enforced change in policy could jeopardise the development of competition which is already underway.

## III. NON-GEOGRAPHIC NUMBER PORTABILITY

39. The regulatory regime in the UK obliges BT to provide portability of all numbers - without reference to the services for which they are used. In the case of non-geographic numbers, BT has needed to undertake some network systems development in order to be able to provide portability. This development work will be completed in May 1997 and, following an initial trial, portability is expected to become available in July 1997. This will include the portability of 0800 numbers used for country direct services.

## IV. INTERCONNECTION

### Interconnection Charges

40. Several of the parties made comments about the UK interconnection regime. Not all of these gave a full assessment of the regime, which is set out below.

41. BT must provide non-discriminatory cost-orientated interconnection services to other operators.

42. Establishing the right arrangements for setting BT s interconnection charges is probably the most important element in the competitive framework in UK telecoms. Interconnection charges - the charges other operators pay BT for use of its network - can account for up to 50% of other operators costs. BT is required to 'charge itself for its own use of its network, through transfer charges between its businesses, the same rates it charges other operators (ie Condition 17 provides that BT may not unduly prefer or discriminate between other operators or between other operators and its own downstream businesses). It is, therefore, vitally important that BT s interconnection charges are soundly derived from appropriate costs and give proper economic signals to other operators to guide their investment decisions.

43. BT currently produces twice yearly Regulatory Accounts These show the financial performance of the six regulatory businesses. The regulatory businesses - three retail businesses, Access, Network and Residual (to reconcile back to the statutory accounts) - do not match the organisation of business which BT uses for its statutory accounts but the division is that which matters for effective regulation. Accounting Separation has two purposes:

– to ensure that interconnection charges are properly and fairly derived from underlying costs (the Regulatory Accounts therefore need to show the financial performance of the Network business separately); and

– to ensure that BT is not unfairly cross-subsidising any of its activities. (If OFTEL is to deal effectively with allegations of unfair cross-subsidy, then it has to understand in detail the way BT allocates costs between businesses and products/services.)

44. Currently OFTEL sets most of BT s interconnection charges. Each year it specifies the charge for each service on BT s standard list of interconnection services on the basis of BT s fully allocated historic costs. These costs are drawn from the Financial Statements - regulatory accounts -which BT is required to produce and publish and which show the activities of BT Network as a business separate from BT Retail and other regulatory businesses. BT is required to attribute network costs to unbundled components of the network according to the principles set out in published Accounting Documents. The unbundled component costs are set out in the Financial Statements which also show how the costs of interconnection services are built up from the individual component costs. OFTEL excludes from its calculations (and BT's determined charges) costs incurred by BT that OFTEL considers are not relevant to the provision of network services.

45. This system was introduced as part of the framework of Interconnection and Accounting Separation set up in March 1995. It has provided the industry with greater transparency and confidence in the setting of interconnection charges and has provided a firm basis for tracking cost allocations. It has been a necessary step in the development from a duopoly environment towards a competitive, multi-operator market. However, it requires OFTEL, as the regulator, to be centrally involved in fixing charges and provides little scope for allowing market forces to set charges as competition develops. OFTEL considers, and the industry agrees, that the present arrangements are not appropriate for the future. As the industry becomes more competitive at the network level, detailed regulatory intervention in setting charges should be withdrawn.

46. OFTEL is, therefore, now well advanced in consulting with the industry on new arrangements for setting interconnection charges which we expect to put into effect from August 1997. OFTEL proposes to change both the basis on which interconnection charges are set and the process of setting them.

47. OFTEL s proposals are for a move to a system of interconnection charge controls from August 1997 which will:

- Change the cost base for interconnection charges from fully allocated historic costs to long run incremental costs - better reflecting the basis on which commercial businesses in competitive markets make investment decisions and thus providing the industry with more appropriate price signals*(see Network Charges from 1997, and*

*NERA's reports to OFTEL on the reconciliation of the bottom-up model to the top-down model).*

- Remove the need for annual determinations and detailed regulatory intervention. Instead OFTEL will set a broad framework of controls within which BT will have pricing flexibility to set its own charges. The degree of control will depend on the competitiveness of the service concerned:

  – for competitive services: BT will be free to set charges (subject to the generally applicable provisions of the licence);

  – for prospectively competitive services (those which are likely to become competitive during the period of the controls). OFTEL will set a safeguard cap of RPI+0% so that charges cannot rise in real terms. This will essentially be a back-stop provision - if services are becoming competitive, prices will be driven down below the safeguard level by competition;

  – for bottleneck and non-competitive services: charge caps will be introduced on two separate baskets of interconnection services to ensure that charges reflect efficiencies BT could be expected to achieve in reducing its network costs. The weighted average charge for services in the baskets will be allowed to increase by no more than RPI-X each year. These charge controls follow the same principles as the familiar retail price caps. There will be one basket for call termination services and a separate one for general network services; and

  – for interconnect specific services (which BT provides to other operators but does not use itself): specific controls are needed as BT has little incentive to keep costs down.

- Include transparent guidelines on how OFTEL will approach complaints about anti-competitive charging.

48. Operators will be able to ask OFTEL, as the sector specific regulator and competition authority, to investigate any charges that they feel are anti-competitive.

**Fair Trading Condition**

49. The Fair Trading Condition ("FTC") was incorporated into BT's licence with BT's consent on 1 October 1996. The FTC introduces into the UK telecommunications regulatory regime a licence condition closely modelled on Articles 85 and 86 of the Treaty of Rome, prohibiting abuse of a dominant position, and the making of any restrictive agreement which has the object or effect of restricting, distorting or preventing competition in the field of telecommunications. Furthermore, because the FTC focuses on preventing behaviour which has an anti-competitive effect, and does not prohibit specified forms of behaviour outright, it gives licensees greater scope to compete legitimately in the market. In turn, this has the effect of providing greater incentives for investment and innovation, which is beneficial for consumers.

50. Incorporation of the condition across the regime enables OFTEL to deal effectively with anti-competitive behaviour with an effect in the UK telecommunication market, irrespective of the identity of the offending party. The FTC is being introduced into existing and new licences. The condition already appears in the Conditional Access Class Licence (issued earlier this month) and the International Facilities licences (issued on 19 December last year). It is also included in OFTEL's proposed modifications to the telecommunications licence of Mercury Communications Limited.

51. Prior to inclusion of the FTC in the UK telecommunications regime, a large number of conditions governing the behaviour of licensees contained outright *a priori* prohibitions and were prescriptive, ruling out certain forms of behaviour in advance simply because they *could* give rise to anti-competitive effects under certain circumstances. These conditions could have limited shelf-life: as the market became increasingly dynamic, operators were able to circumvent them with increasing frequency. This left OFTEL having to modify licences (a lengthy process) whenever it wished to tackle new forms of anti-competitive behaviour. This problem was compounded by the fact that conditions were becoming increasingly detailed, each time a new regulatory 'gap' was plugged.

52. With the FTC however, much of the detail in terms of the ambit and application of the condition is contained in OFTEL's guidelines, general principles of directly applicable competition case law, in particular as laid down by the Court of Justice of the European Union, and decisions of the European Commission in applying the competition rules contained in the EC Treaty. This means that the scope of the condition is not 'frozen' in the licence, but capable of evolving in line with the

market developing in a way which is consistent with European Union competition law. Consequently, the condition is unlikely to become increasingly inflexible - and possibly inappropriate - simply with the passage of time, as detailed, form based conditions have tended to do. In short, the FTC provides OFTEL with the tools which are essential for it to deal flexibly and speedily with potential anti-competitive behaviour, without having to impose intrusive, detailed, and rigid *a priori* prohibitions.

## V. ACCESS TO INTERNATIONAL FACILITIES

### Introduction

53. Operators supplying international services require access to international capacity. It is an upstream input for competitors in the market for supply of international services (switched calls and non-switched private circuits). International capacity includes both international private leased circuits ("IPLCs") and international facilities (backhaul, cable station access and undersea cable capacity).

54. Until 18 December 1996 (when 45 international facilities licences were issued) only BT and Mercury were licensed to own and operate international facilities in UK. Other international operators providing international services could either obtain international capacity (IPLCs) to compete as international simple resellers or resell BT's or Mercury's international calls.

55. The costs of international calls (IDD) and IPLCs were therefore determined by OFTEL on an historic fully allocated basis (*see various Standard Services Determinations and IPLC Determination)*

56. When the UK government announced last summer that it intended to issue new international facilities licences, OFTEL reassessed its regulation of international markets. Regulation is a poor substitute for competition, so all elements were analysed to identify where competition was possible. However, any potential bottlenecks were identified so that they could effectively be regulated to ensure any market power possessed by the incumbent former duopolists could not be abused.

57. In order for resale competition to be sustainable in the long run, competition in upstream markets must be facilitated where possible as only effective infrastructure competition will deliver long-term falling input costs for resellers. It also believes that over prescriptive regulation stifles innovation and competition and so has sought to impose the minimum necessary regulation. Licence conditions governing the behaviour of BT and Mercury in their domestic activities are directly applicable to their international activities.

### The US/UK International Capacity Market

58. IPLCs are close substitutes for the combination of backhaul, cable station access and undersea cable capacity. In order for non-incumbent operators to invest in infrastructure they need an economic incentive to do so. If an incumbent's infrastructure is available at "cost" to competitors (leaving aside the detailed arguments about how exactly this is defined) then an incentive will not exist. However, there are certain circumstances in which new entrants need access to the incumbents's network service at cost-orientated charges:

- if an incumbent's infrastructure cannot be reasonably replicated (ie it is a bottleneck); or

- a market entrant needs conveyance services over part of the incumbent's network to complete a call (ie the new market entrant should not be placed at a disadvantage just because he has not replicated all parts of an incumbents network that can be reasonable replicated).

59. This meant that before international liberalisation IPLC charges were set at fully allocated cost by OFTEL (as they could not reasonably be replicated due to a lack of international facilities licences allowing them to do so), however OFTEL has proposed that from August 1997 BT will not be obliged to provide them at cost (*See Network Charges from 1997*). In order for this policy to have the desired effect of competition lowering wholesale IPLC prices, it is essential that new international facilities operators do not face any barriers to entry. The different areas that need to be considered are backhaul, cable station access and undersea cable capacity.

**Backhaul**

60. This is a high capacity inland private circuit between a cable landing station and another operator's switch. Provided operators can connect to international capacity at cable stations there are no significant barriers to entry. Any UK long distance facilities based operator can use elements of their existing network to provide backhaul, and Energis and MFS have done so to self-provide rapidly (within 3 weeks of their international licences being granted) backhaul from Lands End (where TAT 12/13 terminates).

61. In the UK both domestic PTO licensees and international facilities licensees (if they have requested it) have Telecommunications Code powers. These powers give

the operators deemed planning permission for telecommunications systems (eg backhaul), allow them to apply to the courts for compulsory wayleaves and provide a streamlined coordination procedure for dealing with all relevant UK authorities. The practical effect of this is that backhaul can be constructed quickly with the minimum of "bureaucratic red-tape" restrictions.

62. The speed at which alternative backhaul may be self-provided in the UK is helped by the fact that the major national infrastructure providers (Energis, MFS, NTL and RACAL, as well as BT and Mercury) already have networks close to some cable stations meaning that in many cases less than 10 km of new transmission capacity needs to be installed.

63. BT is obliged to supply backhaul to other operators under Condition 1 and Condition 46 of its licence and the supply is subject to Condition 16 (publication of tariffs), Condition 17 (non-discrimination and preference) and Condition 18A (fair trading). We are closely monitoring the development of alternative backhaul provision in the UK. Although the plans of individual companies are confidential, from our discussions with the industry we understand that alternative backhaul is planned with the next year to almost all cable stations.

64. For the reasons set out earlier we have not price controlled BT's backhaul prices (which BT has initially priced at a level similar to its charges for non-switched transit capacity across the UK, and which are lower than inland private circuit prices). These prices have been available since 19 December 1996 and, as yet, have not changed in response to backhaul competition.

**Cable Landing Station Access**

65. This is the means by which an international operator connects offshore cable capacity to inland backhaul. In the UK no separate landing licences are needed to land new undersea cables or construct cable landing stations. BT and Mercury, as cable station owners, currently have bottleneck control. BT and Mercury are obliged to supply access (in-span handover - "ISH") under the interconnection obligations of their Licences (Conditions 12 and 13) on cost-orientated terms. Supply is subject to Condition 16A (publication of interconnection tariffs), Condition 17 (non-discrimination and preference) and Condition 18A(fair trading) so that other operators can obtain access to the same functionality as BT and Mercury at the same cost as the incumbents